No. 22304

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

ASSOCIATED MACHINE (formerly Associated Machine Shop), a corporation,

Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

FILED

APR 25 1968

WM. B. LUCK, CLERK

MITCHELL ROGOVIN,
Assistant Attorney General.

LEE A. JACKSON,
HARRY BAUM,
MARTIN T. GOLDBLUM,
Attorneys,
Department of Justice,
Washington, D.C. 20530.

I N D E X

Page

Opinion below -- 1
Jurisdiction --- 1
Question presented ----------------------------------- 2
Statutes and Regulations involved ------------------- 2
Statement -- 3
Summary of argument ---------------------------------- 5
Argument:

The amalgamation of separate corporate enterprises in not an "F" reorganization ------- 10

A. Introduction --------------------------- 10

B. The scheme of the reorganization provisions and the language and history of Section 368(a)(1)(F) indicate that the "F" provision is limited to formalistic changes in a single corporate enterprise ------- 13

C. Section 381 and its history demonstrate that (1) an "F" reorganization does not include more than a single corporate enterprise and (2) the survivor of a merger (the acquiring corporation) may not carry back a net operating loss to a taxable year of the transferor corporation --------------------------- 16

D. There is no merit to petitioner's argument that the pre-merger separate existence of J & M is to be disregarded -------------------------------- 26

Conclusion --- 28
Appendix --- 29

CITATIONS

Cases:

<u>Ahles Realty Corp</u>. v. <u>Commissioner</u>, 71 F. 2d 150, certiorari denied, 293 U.S. 611 ------ 15
<u>Aldon Homes, Inc</u>. v. <u>Commissioner</u>, 33 T.C. 582-- 26, 27
<u>Associated Machine</u> v. <u>Commissioner</u>, 48 T.C. 318- 1
<u>Berghash</u> v. <u>Commissioner</u>, 43 T.C. 743, affirmed, 361 F. 2d 257 ------------------------------ 14

Page

Cases (continued):

Columbia Gas of Maryland, Inc. v. United States, 366 F. 2d 991 ------------------ 12, 16
Commissioner v. Baan, 382 F. 2d 485, certiorari granted, No. 781 ------------- 11, 14, 24
Commissioner v. State-Adams Corp. 283 F. 2d 395 ------------------------------------ 26, 27
Davant v. Commissioner, 43 T.C. 540, modified, 366 F. 2d 874 --------------------------- 9, 13
Davant v. Commissioner, 366 F. 2d 874, certiorari denied, 386 U.S. 1022 ------- 13, 25
Helvering v. Southwest Consolidated Corp., 315 U.S. 194 ---------------------------- 12, 15
Libson Shops, Inc. v. Koehler, 353 U.S. 382 - 12, 20
Marr v. United States, 268 U.S. 536 --------- 16
Moline Properties v. Commissioner, 319 U.S. 436 ------------------------------------- 27
Newmarket Manufacturing Co. v. United States, 233 F. 2d 493 -------------------------- 12, 14, 20
Pridemark, Inc. v. Commissioner, 42 T.C. 510, reversed on other grounds, 345 F. 2d 35- 9, 13
San Joaquin Fruit & Inv. Co. v. Commissioner, 77 F. 2d 723, reversed on other grounds, 297 U.S. 496 --------------------------- 15
Shaw Construction Co. v. Commissioner, 323 F. 2d 316 -------------------------- 26, 27
Stauffer, Estate of v. Commissioner, 48 T.C. 277, pending on appeal, Nos. 22277, 22277A and 22277B --------------------- 5, 7, 9, 12, 1
18, 19, 24, 25
Whittel, George, & Co. v. Commissioner, 34 B.T.A. 1070 ------------------------- 15

Statutes:

Internal Revenue Code of 1954:
Sec. 11 (26 U.S.C. 1964 ed., Sec. 11) -- 24
Sec. 172 (26 U.S.C. 1964 ed., Sec. 172)- 29
Sec. 332 (26 U.S.C. 1964 ed., Sec. 332)- 10, 19
Sec. 354 (26 U.S.C. 1964 ed., Sec. 354)- 11, 15, 23
Sec. 355 (26 U.S.C. 1964 ed., Sec. 355)- 11, 14, 23
Sec. 368 (26 U.S.C. 1964 ed., Sec. 368)- 10, 30
Sec. 381 (26 U.S.C. 1964 ed., Sec. 381)- 10, 17, 31
Sec. 1244 (26 U.S.C. 1964 ed., Sec. 1244) ------------------------------ 24
Sec. 6211 (26 U.S.C. 1964 ed., Sec. 6211) ------------------------------ 32

Page

Statutes (continued):

Revenue Act of 1921, c. 136, 42 Stat. 227, Sec. 202 ---------------------------------- 15
Revenue Act of 1924, c. 234, 43 Stat. 253, Sec. 203 ---------------------------------- 15

Miscellaneous:

Bittker & Eustice, Federal Income Taxation of Corporations and Shareholders (2d ed.), pp. 507, 548 ---------------------------- 14, 15
1 Senate Hearings before the Committee on Finance on the Internal Revenue Code of 1954, 83d Cong., 2d Sess., pp. 403, 539 - 16
Rev. Rul. 58-422, 1958-2 Cum. Bull. 145, 146 - 19, 25
S. Rep. No. 1622, 83d Cong., 2d Sess., pp. 275-277 (3 U.S.C. Cong. & Adm. News (1954) 4621, 4914-4915) ----------------- 8, 18, 23
Treasury Regulations on Income Tax:
Sec. 1.381(a)-1 (26 C.F.R., Sec. 1.381(a)-1) ------------------------- 17, 33
Sec. 1.381(b)-1 (26 C.F.R., Sec. 1.381(b)-1) ------------------------- 10, 17, 34
Sec. 1.381(c)(1)-1 (26 C.F.R., Sec. 1.381(c)(1)-1) --------------------- 17, 18, 35

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

No. 22304

ASSOCIATED MACHINE (formerly Associated Machine Shop), a corporation,

Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

OPINION BELOW

The findings of fact and opinion of the Tax Court (I-R. 76-98) are reported at 48 T.C. 318.

JURISDICTION

This petition for review (I-R. 100-103) involves federal income taxes of $43,088.91 for the taxable year 1959. On June 2, 1965, the Commissioner of Internal Revenue mailed a notice of deficiency, asserting the deficiency in tax. (I-R. 4-5.) Within ninety days thereafter, on August 30, 1965, taxpayer filed a petition with the Tax Court for a redetermination of that deficiency under the provisions of Section 6213 of the Internal Revenue Code of 1954. (I-R. 1-6.) The decision of the Tax Court was entered June 15, 1967.

(I-R. 99.) The case is brought to this Court by petition for review filed September 15, 1967 (I-R. 100-103), within the three-month period prescribed in Section 7483 of the Internal Revenue Code of 1954. Jurisdiction is conferred on this Court by Section 7482 of that Code.

QUESTION PRESENTED

Section 381(b) of the Internal Revenue Code of 1954 provides that a corporation which transfers its assets to another corporation pursuant to certain types of tax-free reorganizations must end its taxable year on the date of the transfer, and that the acquiring corporation may not carry back a net operating loss for a taxable year ending after the transfer to a taxable year of the transferor corporation, "except" in the case of a reorganization as defined in Section 368(a)(1)(F), i.e., "a mere change in identity, form, or place of organization" of the transferor corporation.

The question is whether the merger of two corporations, which had been conducting separate businesses, constituted an "F" reorganization ("a mere change in identity, form, or place of organization") so as to come within the exception provision of Section 381(b), as the petitioner contends, or solely an "A" reorganization ("a statutory merger"), as the Tax Court held.

STATUTES AND REGULATIONS INVOLVED

The relevant statutes and Regulations are set out in the Appendix, infra.

STATEMENT

The facts as stipulated (I-R. 12-20) were adopted by the Tax Court (I-R. 78), and its findings (I-R. 78-88) may be summarized as follows:

Associated Machine Shop (hereafter taxpayer) was a corporation organized on September 10, 1958, principally to carry on the business of fabricating metal parts for use in aircraft, missiles and computers. All of its 503 outstanding shares were owned by Joseph Schiavo. Taxpayer reported its income on a calendar year basis and employed the accrual method of accounting. For 1959, taxpayer's taxable income was $142,655.06. (I-R. 79-80.)

On December 14, 1959, Mr. Schiavo organized a second corporation, J & M Engineering, primarily to conduct a sheet metal fabrication business (the making of cabinets and other such items out of sheet metal). Mr. Schiavo owned all of the 50 outstanding J & M shares. J & M reported its income on a fiscal year basis, from December 1 to November 30, and employed the accrual method of accounting. (I-R. 81-82, 86.) For its initial fiscal period (December 14, 1959, to November 30, 1960), J & M reported an operating loss of $101.70 (I-R. 85) which was thereafter adjusted on audit to $3,641.70 (I-R. 87).

On November 5, 1960, taxpayer and J & M entered into a merger agreement which provided that J & M would be the surviving corporation and that taxpayer would end its existence. In addition, the agreement provided that, as of the effective date of the merger (the date of filing the executed merger agreement with the Secretary of the State of California), the name of J & M would be changed to Associated

Machine and its articles of incorporation would be so amended. The merger was accomplished on November 30, 1960, in accordance with the agreement. Mr. Schiavo received 503 shares of J & M stock in exchange for his 503 shares of the stock of taxpayer. (I-R. 82, 85-86.)

Taxpayer filed a closing tax return for the period January 1 to November 30, 1960, and reported income of $26,790.66. (I-R. 87.)

As stated, J & M had incurred a net operating loss of $3,641.70 for the fiscal period ended November 30, 1960. This loss was carried forward and allowed as a deduction against the income of Associated Machine (formerly J & M and the petitioner here) for the fiscal year ended November 30, 1961. 1/ (I-R. 87.)

For its fiscal year ending November 30, 1962, petitioner reported a loss of $82,863.30. On February 18, 1963, it filed an "Application for Tentative Carryback Adjustment", carrying back the loss to offset taxpayer's pre-merger income for the calendar year 1959. On the application it was stated that "Associated Machine Shop [taxpayer] merged with Associated Machine [petitioner] 11-30-60. This application is being filed by Associated Machine [petitioner], but the carryback pertains to Associated Machine Shop [taxpayer] for the calendar year 1959." The Commissioner, on March 12, 1963, allowed the tentative carryback adjustment in the full amount claimed and thus refunded $43,088.91, plus interest. (I-R. 87-88.)

1/ Associated Machine (petitioner) continued to file its returns on the same fiscal basis as it had when its name was J & M.

In a statutory notice of deficiency, dated June 2, 1965, the Commissioner asserted a deficiency in tax for the calendar year 1959 in the amount refunded, on the ground that it was improper to carry back petitioner's loss to a pre-merger year of taxpayer. (I-R. 88.) 2/ Section 381(b)(3) of the 1954 Code precludes such a carryback except for a reorganization under Section 368(a)(1)(F), i.e., "a mere change in identity, form, or place of organization, however effected."

In the Tax Court, petitioner maintained that its acquisition of taxpayer's assets pursuant to a tax-free reorganization under Section 368(a)(1)(A) of the 1954 Code ("a statutory merger") also qualified under Section 368(a)(1)(F). The Tax Court, in accord with Estate of Stauffer v. Commissioner, 48 T.C. 277, pending on appeal to this Court (Nos. 22277, 22277A, and 22277B), held that the merger of separately-operated corporate enterprises (two brother-sister corporations in this case) does not constitute an "F" reorganization. (I-R. 91-92.)

SUMMARY OF ARGUMENT

The issue here is substantially the same as that presented in Estate of Stauffer, supra. Both of these decisions of the Tax Court are entitled to affirmance for the same reasons.

While Congress has accorded nonrecognition of gain or loss treatment to all corporate "reorganizations" as defined in subparagraphs A to F of Section 368(a)(1) of the 1954 Code, it has expressly declined to treat all reorganizations alike for other tax purposes.

2/ The notice of deficiency was addressed to "Associated Machine (formerly Associated Machine Shop)." That designation meant that the deficiency related to the pre-merger income of taxpayer for its 1959 calendar year. Of course, J & M Engineering was the former name of petitioner, Associated Machine. (I-R. 88.) In short, the notice of deficiency and the caption of this case make reference to petitioner in its capacity as the successor of taxpayer by statutory merger, although petitioner is actually J & M with a changed name.

In Section 381 it set out in detail the extent to which the "acquirin corporation" in certain tax-free "reorganizations" (those defined in Section 368(a)(1)(A), (C), (D), and (F)) may "succeed to and take into account" specified tax "items" of the transferor corporation. Section 381(a) sets forth the general rule, "subject to the condition and limitations specified in subsections (b) and (c)." Subsection (c lists the particular items to which the general rule applies (e.g., net operating loss carryovers, earnings and profits, methods of accounting, inventories, depreciation allowances). Subsection (b), captioned "Operating Rules", contains additional limitations: it requires that the taxable year of the transferor corporation shall en on the date of the transfer (Section 381(b)(1)), and it precludes the acquiring corporation from carrying back a net operating loss for a taxable year ending after the reorganization transfer to a taxable year of the transferor corporation (Section 381(b)(3)). These limitations of Section 381(b) apply to all transactions listed in Sectior 381(a) "except in the case of an acquisition in connection with a reorganization described in subparagraph (F) of section 368(a)(1)." Section 368(a)(1) in turn defines an "F" reorganization as "a mere change in identity, form, or place of organization, however effected. Accordingly, under the express terms of Section 381, the taxable yea of the transferor corporation terminates, and a net operating loss carryback privilege otherwise available to a corporation under Section 172 is not available, even in the case of a tax-free reorgan zation, <u>unless</u> the reorganization qualifies as an "F" type.

In this case, two brother-sister corporations (taxpayer and J & M), carrying on separate businesses, merged under the laws of California. The separate enterprises formerly conducted by the two corporations were combined and thereafter conducted as one by J & M, the surviving corporation. The Tax Court, consistent with its prior unanimous ruling in Estate of Stauffer v. Commissioner, 48 T.C. 277, pending on appeal to this Court (Nos. 22277, 22277A, and 22277B), held that the merger constituted solely an "A" reorganization ("a statutory merger"), not an "F" reorganization ("a mere change in identity, form, or place of organization"), and therefore did not come within the exception provision of Section 381(b). In so holding, the Tax Court reached the only conclusion compatible with the terms and history of Section 381, the terms and history of the reorganization definitions in Section 368(a), the inter-relationship of those sections and other sections of the Code, the applicable Treasury Regulations, and the relevant decisions.

The reason for the statutory exception in Section 381(b) in favor of "F" reorganizations is apparent from the very statutory description of that kind of reorganization as compared with other kinds (subparagraphs A through E of Section 368(a)(1)). The definition of an "F" reorganization -- "a mere change in identity, form, or place of organization" -- is stricter than that of other types; it is limited to mere formalistic changes in the charter or place of organization of a single corporate enterprise, such as reincorporation in another state, and does not encompass an amalgamation of two or more operating corporations. In the few instances in which the "F"

reorganization definition was applied up to the time of its inclusion in the 1954 Code, it was applied to the reincorporation of a single corporate enterprise, and it was in that setting that Congress re-enacted the definition in Section 368 and incorporated it by referenc in Section 381. In harmony with the legislative history of Section 381 (S. Rep. No. 1622, 83d Cong., 2d Sess., pp. 275-277) and the rigorous definitional requirements of an "F" reorganization, the long-standing Treasury Regulations provide that in the case of a reorganization qualifying under subparagraph F of Section 368(a)(1), the "acquiring corporation" will be treated for purposes of Section 381(b) "just as the transferor corporation would have been treated if there had been no reorganization." Regulations Section 1.381(b)-1 (a)(2). And it is abundantly clear from the examples given in the explanatory Senate Finance Committee Report and the Treasury Regulati that a merger of two or more operating companies constitutes an "A" reorganization, not an "F" reorganization, for purposes of applying the exception provision of Section 381(b). S. Rep. No. 1622, supra, p. 276; Regulations Section 1.381(c)(1)-1(b).

Unless the Congressional distinction between an "F" vis-a-vis an "A" reorganization is to be obliterated, an "F" reorganization is necessarily limited to the reorganization of a single corporation, an does not embrace a fusion of two or more operating corporations. Wherever the demarcation line between an "A" and an "F" reorganizatio is to be drawn, it is plain that an amalgamation of two or more corporate ventures into a single corporate enterprise is more than an "F" reorganization ("a mere change in identity, form, or place of

organization"), and falls on the "A" side of the line ("a statutory merger or consolidation"). While the merger of a single corporation into a newly-created one (reincorporation) may qualify as both an "A" and "F" reorganization, the merger or consolidation of two or more existing corporations cannot. To hold otherwise would for all practical purposes erase any meaningful difference between an "A" and an "F" reorganization, upon which the applicability of Section 381(b) expressly hinges.

The only authority which may be considered contrary to the Tax Court's decision here is a prior decision of the Tax Court itself (Pridemark, Inc. v. Commissioner, 42 T.C. 510, reversed on other grounds, 345 F. 2d 35 (C.A. 4th)), which has been properly (and unanimously) overruled by that court's later and more thoroughly reasoned opinion in Stauffer. And, in Davant v. Commissioner, 43 T.C. 540, modified, 366 F. 2d 874 (C.A. 5th), upon which petitioner also relies, the Tax Court held that the transaction constituted a "D" reorganization, and the Fifth Circuit's alternative holding that it also constituted an "F" reorganization was unnecessary to its decision.

Taxpayer's alternative contention that the separate pre-merger existence of J & M should be ignored is utterly without merit. It is elementary that a corporation formed to serve any business purpose is a separate taxable entity, which its creator is not at liberty to disregard. The record plainly shows, as the Tax Court found, that J & M performed substantial business activities, distinct from those carried on by the taxpayer corporation.

ARGUMENT

THE AMALGAMATION OF SEPARATE CORPORATE ENTERPRISES IS NOT AN "F" REORGANIZATION

A. Introduction

Section 381 of the Internal Revenue Code of 1954, Appendix, infra, 3/ permits a corporation that acquires the assets of another corporation, through the tax-free liquidation of a subsidiary (Section 332) or through certain types of corporate reorganizations (Section 368(a)(1), Appendix, infra), to "succeed to" various tax and accounting attributes of "the distributor or transferor corporation." It also imposes limitations and conditions which concern both the transferor corporation and the acquiring corporation. Two inter-related limitations are that the taxable year of the transferor corporation must end on the date of the transfer (Section 381(b)(1)), which means that the transferor corporation is to file a closing tax return at that time notwithstanding that its usual taxable year would not have ended at that time (Section 1.381(b)-1(c), Treasury Regulatio on Income Tax (1954 Code), Appendix, infra); 4/ and the acquiring corporation may not carry back a post-reorganization net operating loss "to a taxable year of the * * * transferor corporation." (Section 381(b)(3)). These restrictions do not apply, however, if the reorganization is one described in Section 368(a)(1)(F) -- "a mere change in identity, form, or place of organization, however effected."

3/ Section references hereafter are to those of the Internal Revenue Code of 1954, unless otherwise indicated.

4/ References to Treasury Regulations hereafter are to those promulgated under the 1954 Code.

Petitioner claims that its acquisition of the assets of taxpayer pursuant to a statutory merger (Section 368(a)(1)(A)) also qualified as an "F" reorganization because there was complete continuity of enterprise and shareholder interest. Nevertheless, taxpayer (the transferor corporation) ended its taxable year on the date of the merger and filed a closing return covering its separate operations for the portion of its 1959 calendar-taxable year prior to the merger (January 1, 1960, to November 30, 1960) (I-R. 82, 87), as required by Section 381(b)(1) and Treasury Regulations, Section 1.381(b)-1(c). This is significant for, as will be discussed in Point C, infra, that was the only logical approach and it shows that Congress could not have intended that an amalgamation of separately-operated and taxed entities be considered an "F" reorganization.

Moreover, continuity of ownership and business enterprise is, in the general sense in which petitioner uses it, true of every tax-free reorganization defined by Section 368(a)(1). Subdivisions (A) through (D), coupled with Section 354, permit various amalgamating reorganizations in which multiple corporate enterprises may be combined into one corporation. Subdivision (D) and Section 355 permit a divisive reorganization such as a "spin-off," where "a part of the assets of a corporation is transferred to a new corporation and the stock of the transferee is distributed to the shareholders of the transferor." See Commissioner v. Baan, 382 F. 2d 485, 491 (C.A. 9th), pending in the Supreme Court on grant of certiorari (October, 1967 Term, No. 781). Subdivision (E) permits a recapitalization, i.e., the "reshuffling of a capital structure, within the framework of an

existing corporation." Helvering v. Southwest Consolidated Corp., 315 U.S. 194, 202. There is complete continuity of business enterprise in each of these reorganizations in that all business assets remain in corporate solution. What petitioner's argument is reduced to, then, is that the sole criterion of an "F" reorganization is identity of ownership; that an amalgamating or divisive reorganization is "a mere change in identity, form, or place of organization" if the shareholders of the new corporation are the same as the old. This has been rejected by the Court of Claims as to a divisive reorganization in Columbia Gas of Maryland, Inc. v. United States, 366 F. 2d 991 (100 percent continuity of ownership in the resulting two corporations). Similarly, the converse situation here, in which identically-owned separate corporate enterprises are combined, requires the same result.

Prior to the ruling in the instant case, the Tax Court, in a reviewed decision (per Judge Raum), unanimously concluded that such an amalgamation is not a "mere change" in form or identity within the meaning of the "F" provision. Estate of Stauffer v. Commissioner, 48 T.C. 277, pending on appeal to this Court (Nos. 22277, 22277A, and 22277B). Cf. Libson Shops, Inc. v. Koehler, 353 U.S. 382, 387-388. 5/ So doing, the court properly departed from its prior decision in

5/ The Supreme Court specifically approved Newmarket Manufacturing Co. v. United States, 233 F. 2d 493, 497 (C.A. 1st), which held under the 1939 Code that after reincorporation of a single enterprise in another state a carryback was permissible because it was the same in all respects as its predecessor except for the change in corporate domicile. The Supreme Court pointed out that the difference between amalgamating separately-operated and taxed enterprises and reincorporating a single corporate enterprise "is not merely a matter of form." 353 U.S., p. 388.

Pridemark, Inc. v. Commissioner, 42 T.C. 510, reversed on other grounds, 345 F. 2d 35 (C.A. 4th), and refused to follow an alternative holding in Davant v. Commissioner, 366 F. 2d 874, 884 (C.A. 5th), certiorari denied, 386 U.S. 1022. Although the Internal Revenue Service has previously taken the position that a tax-free merger of two or more enterprises could be an "F" reorganization, that position was reconsidered and rejected in light of the history of the "F" provision and other provisions of the 1954 Code. The Commissioner therefore did not maintain that the merger of brother-sister corporations in Davant was an "F" reorganization on appeal to the Fifth Circuit, but argued only that it was a nondivisive "D" reorganization. The Fifth Circuit nevertheless held that the transaction was both an "F" and a "D" reorganization. 6/ As Judge Raum's opinion in Stauffer points out (48 T.C., p. 303), the Solicitor General opposed certiorari in Davant on the ground that the transaction was a "D" reorganization and did not argue the applicability of Section 368(a)(1)(F). We believe that the Tax Court's unanimous decision in Stauffer is unmistakably correct and has been correctly applied in the instant case. 7/

B. The scheme of the reorganization provisions and the language and history of Section 368 (a)(1)(F) indicate that the "F" provision is limited to formalistic changes in a single corporate enterprise

The scheme of Section 368(a)(1) suggests a descending order of significance, with subdivision (F) as the least consequential of any

6/ In Davant the Tax Court held (43 T.C. 540) that the transaction was a "D" (not an "F") reorganization. The Fifth Circuit's holding that it was also an "F" reorganization was unnecessary to its decision.

7/ The Commissioner's brief here is in most respects identical to that filed in Stauffer.

reorganization. Subdivisions (A) through (D), as noted, involve business combinations and divisions; subdivision (E), the structure of a single corporate enterprise. The "F" provision, like the "E", does not describe any particular type of intercorporate transaction -- such as a statutory merger or consolidation -- but simply indicates the result that may be accomplished "however effected." That result is the very limited one of "a mere change in identify, form, or place of organization." Considered in its context, that language simply means a reincorporation (a new charter) in the same or in another state and no more. See Berghash v. Commissioner, 43 T.C. 743, 752, affirmed, 361 F. 2d 257 (C.A. 2d); cf. Newmarket Manufacturing Co. v. United States, 233 F. 2d 493, 497 (C.A. 1st). To be sure, the other categories of reorganizations are in a sense concerned with changes in identity or form, but they are not "mere" changes; and to give the "F" provision a broad reading would be to engulf other types of reorganizations, such as the divisive "D", without assimilating their restrictions (see the highly articulated Section 355 and this Court's opinion in Commissioner v. Baan, supra). In other words, subdivisions (E) and (F) are similar in that they do not describe a transaction between corporations, but relate to an *intra*corporate transaction which results in a change in either the capital or the corporate structure. Thus, the "E" and "F" provisions are said to apply to "'internal' readjustments in the structure of a single corporate enterprise." Bittker & Eustice, Federal Income Taxation of Corporations and Shareholders (2d ed.), p. 507.

The historical setting in which Congress re-enacted the "F" provision into the 1954 Code confirms that understanding of its limited reach. The provision was derived without substantial change, from the Revenue Act of 1921, c. 136, 42 Stat. 227, Sec. 202(c). In the period before adoption of the 1954 Code, it was applied where there was a reincorporation of a single corporate enterprise. 8/ E.g., San Joaquin Fruit & Inv. Co. v. Commissioner, 77 F. 2d 723, 724-725 (C.A. 9th), reversed on other grounds, 297 U.S. 496; Ahles Realty Corp. v. Commissioner, 71 F. 2d 150 (C.A. 2d), certiorari denied, 293 U.S. 611; George Whittel & Co. v. Commissioner, 34 B.T.A. 1070. In 1954, the House of Representatives recommended its repeal because the minor alterations it permitted could be accomplished through other types of reorganizations. 9/ See Bittker & Eustice, supra, p. 548. Nonetheless, it apparently was retained "at the request of the tax bar,

---

8/ Certain of these cases were decided under the Revenue Act of 1924, c. 234, 43 Stat. 253, Sec. 203(h)(1)(D), when the "mere change" provision was the "D" reorganization. As additions were made to the reorganization provisions, it became the "E" (see Helvering v. Southwest Consolidated Corp., 315 U.S. 194, 202-203) and finally the "F" in the present Code.

9/ The "F" reorganization is generally accomplished by one of the other forms of reorganization, since no particular steps are indicated by the statute. For example, existing corporation X can merge into newly-formed corporation Y through a statutory merger under Section 368(a)(1)(A) or by a transfer of all its assets under Sections 368(a)(1)(D) and 354(b). Since Y started out as a shell and on the reorganization acquired all the characteristics of X, the only result is a change in the identify, form, or place of organization of X. However, the fact that a transaction which takes the form of an "A", or nondivisive "D", reorganization can amount to merely an "F" has led to some of the confusion regarding the scope of subdivision (F). The confusion results from assuming that if an "A" can be an "F", every "A" is an "F". But, of course, a true "A" -- that is, an amalgamation of separate corporate enterprises -- is not the absorption of a single corporate enterprise into a new shell and is therefore not an "F".

representatives of which noted that subparagraph (F) clearly covered reincorporations of all of a corporation's assets in another state or in the same state after expiration of a charter -- transactions which might not meet the other definitions of a reorganization." 10/ Columbia Gas of Maryland, Inc. v. United States, 366 F. 2d 991, 994, fn. 3 (Ct. Cl.): see 1 Senate Hearings before the Committee on Finance on the Internal Revenue Code of 1954, 83d Cong., 2d Sess., pp. 403, 539. When the present Code was enacted, it had never been thought that the "F" reorganization could involve multiple corporate enterprises -- either the amalgamation of separately-operated corporate enterprises or the division of one corporation into two or more entities. And the very narrow scope of the "F" provision was made clear in the sections of the 1954 Code which make reference to it.

C. Section 381 and its history demonstrate that (1) an "F" reorganization does not include more than a single corporate enterprise and (2) the survivor of a merger (the acquiring corporation) may not carry back a net operating loss to a taxable year of the transferor corporation

1. Section 381(b) creates a set of mechanical rules requiring the closing of the taxable year of the transferor corporation on a tax-free reorganization (and the distributor corporation on a tax-free liquidation), and denying the acquiring corporation a carryback to any pre-acquisition taxable year of the transferor (or distributor)

10/ The fears of the tax bar may have been to some extent justified because, under the law prior to the "F" provision, an exchange of stock pursuant to the reincorporation of General Motors (changing its place of organization from New Jersey to Delaware) was held to be taxable. Marr v. United States, 268 U.S. 536.

Thus, in any reorganization there can be but one acquiring corporation (see Treasury Regulations, Section 1.381(a)-1(b)(2)(i), Appendix, *infra*), and that corporation alone survives as the taxpayer. If, for example, corporation X merges into corporation Y (as in the present case), Y is the acquiring corporation and will succeed to X's tax attributes (such as net operating losses) for prospective application under Section 381(c); Y will not be entitled to carry back any post-merger net operating losses to any pre-merger year of X. Section 381(b)(3); Treasury Regulations, Section 1.381(c)(1)-1(b), Example (1), Appendix, *infra*. Section 381(b) would not preclude Y from carrying back to its own pre-reorganization taxable years a net operating loss arising after the merger. 11/ Treasury Regulations, Section 1.381(c)(1)-1(b), Example (1). Thus, the application of Section 381(b) and (c) hinges entirely on the acquiring corporation: it succeeds only prospectively to the tax attributes of the transferor corporation and fully retains its own tax attributes, if any.

Considered in this light, it can be seen why Congress excepted the "F" reorganization from Section 381(b). The reincorporation of a single enterprise in a different state would have required a closing return and loss of a possible carryback when, apart from the change of domicile, the resulting corporation would be the same taxpayer as its predecessor. So the Treasury Regulations, Section 1.381(b)-1(a)(2), Appendix, *infra*, provide that in an "F" reorganization "the acquiring corporation shall be treated * * * just as the transferor corporation

---

11/ Note, however, that a net operating loss of X to which Y may have succeeded as a result of the reorganization could not be carried back to any prior taxable year of Y, but could only be carried forward. Section 381(c)(1)(A).

would have been treated if there had been no reorganization." As Judge Raum stated in Stauffer, "The underlying theory of * * * [this provision] quite plainly is that there is such a complete identity between the pre- and post- reorganization enterprises in an 'F' reorganization that the acquiring corporation is to be treated exactly as the transferor corporation would have been treated in the absence of any reorganization." 48 T.C., pp. 297-298.

The Treasury Regulations (Sections 1.381(b)-1(a)(2) and 1.381(c)(1)-1(b), Examples (1) and (2), Appendix, infra) explain the operation of Section 381(b) in connection with a consolidation, merger, and "F" reorganization. They are directly traceable to the report of the Senate Finance Committee, which did the final drafting of Section 381. Examples given in the report establish that the Tax Court correctly applied Section 381 in this case and in Stauffer (S. Rep. No. 1622, 83d Cong., 2d Sess., p. 276 (3 U.S.C. Cong. & Adm. News (1954) 4621, 4914-4915)):

> Paragraph (3) of subsection (b) provides that an acquiring corporation to which property is distributed or transferred in a corporate transaction described in paragraphs (1) and (2) of subsection (a) (except a reorganization described in subparagraph (F) of section 368(a)(1)) is not entitled to carry back a net operating loss for a taxable year ending after the date of distribution or transfer to a taxable year of the distributor or transferor corporation. For example, [1] assume corporations X and Y transfer on December 31, 1954, all their property to Z in a transaction described in subparagraph (A) of section 368(a)(1). If Z has a net operating loss in 1955, such loss cannot be carried back to a taxable year of X or Y. Or, [2] assume corporation X merges into corporation Y on December 31, 1954, in a statutory merger with Y's charter continuing after the merger. If Y has a net operating loss in 1955, such loss cannot be carried back to a taxable year of X but shall be a carryback to a taxable year

> of Y. [3] If, however, corporation X, in a reorganization described in subparagraph (F) of section 368(a)(1), merely changes its identity, form or place of organization, the resulting corporation is entitled to carry back its net operating loss to a taxable year of X prior to the reorganization. (Emphasis added.)

Example 3 in the excerpt deals with the "F" reorganization situation in regard to a single corporation, and example 1 concerns the situation in Stauffer -- consolidation of existing corporations into a new corporation -- and shows that there is to be no carryback to any taxable years of the constituent companies. Example 2 above deals with a merger of two existing corporations in which one retains its charter and, for that reason, its own tax attributes. This case is precisely the same as example 2. Here, the charter of J & M (albeit with a different name) continued after the merger. A carryback would have been permitted to pre-merger taxable years of J & M if any were available. However, no carryback is permissible to any taxable years of taxpayer, the merged corporation. 12/ Insofar as Section 381 deals with carrybacks, it is thus apparent that Congress infused into the 1954 Code the single business enterprise theory that was

---

12/ Petitioner (Br. 13-14) misstates the holding of Rev. Rul. 58-422, 1958-2 Cum. Bull. 145, in saying that the merger of a parent corporation and its two subsidiaries into a newly-formed corporation "was held to be a Type (F) reorganization." The Ruling held only that the parent's merger into the new shell constituted an "F" reorganization; the "mergers" of the two subsidiaries were held to be "liquidations to which Section 332 applies." Rev. Rul. 58-422, supra, p. 146. (Section 332 provides for the tax-free liquidation of a subsidiary.) The result of that ruling is that the two subsidiaries would be required to file closing returns and that there could be no carryback to their pre-liquidation taxable years under Section 381(a)(1) and (b). Unlike the parent corporation's merger into a newly-formed shell in Rev. Rul. 58-422, supra, taxpayer here merged into an existing corporation (J & M) which had been conducting its own business. Like the two subsidiaries in the Ruling, taxpayer would be required to file a closing return and there could be no carryback to its pre-reorganization taxable years under Section 381(a)(2) and (b).

adopted by the Supreme Court in Libson Shops, supra, and the First Circuit in Newmarket Manufacturing Co. v. United States, 233 F. 2d 493. 13/

The operation of Section 381, reinforced by the plainest legislative declarations and the Treasury Regulations, should be decisive of the present case. But there are, as we will show, even further indications that Congress intended and contemplated that the "F" provision would retain its traditionally limited application to a single corporate enterprise.

2. One of the fundamental principles of Section 381 is that the acquiring corporation shall take into account the tax attributes of the transferor corporation only prospectively. Section 381(c)(1)(A) requires that a net operating loss of the transferor corporation, to which the acquiring corporation succeeds, be carried forward starting with "the first taxable year ending after the date of * * * transfer." Stated another way, the acquiring corporation may not carry back the transferor's net operating loss to any of its pre-reorganization taxable years. Read in this way, it is evident that Section 381(c)(1)(A) is a necessary counterpart to Section 381(b), which precludes a carryback of the acquiring corporation's net operating loss to a pre-reorganization taxable year of the transferor corporation. In combination, Sections 381(b) and 381(c)(1)(A) preven

---

13/ Those decisions, of course, came down under the 1939 Code, but ea made reference to the 1954 provisions that had already been enacted. Newmarket noted that Section 381(b) would have permitted the carrybac in circumstances like those before it (the reincorporation of a singl enterprise in another state). 233 F. 2d, p. 493. The Supreme Court in Libson Shops adopted that same rationale, making special reference to the Newmarket case. It cannot be assumed that these decisions fai to take account of the relevant aspects of the 1954 Code.

the tax attributes of the acquiring corporation to be used retrospectively to change tax results of the pre-reorganization years of the transferor corporation (when it constituted a separately taxed entity), and similarly the tax attributes of the transferor corporation may not be used to alter the pre-reorganization tax results of the acquiring corporation.

Applying petitioner's notion that a reorganization which combines two corporate enterprises can be within the "F" provision, leads to the following anomaly: The highly restrictive Section 381(b), which denies certain advantages to all except the "F" reorganization, would not prevent a carryback of the acquiring corporation's net operating loss to a taxable year of the transferor, whereas Section 381(c)(1)(A) (which does not except the "F" reorganization) would prevent a carryback of the net operating loss of the transferor to a pre-reorganization taxable year of the acquiring corporation even in the case of "a mere change in identity, form, or place of organization" (an "F" reorganization). Plainly, if Congress had intended that the "F" provision encompass more than a single enterprise, it logically would have provided the same exception in Section 381(c)(1)(A) as it provided in Section 381(b). However, the exception for the "F" reorganization in Section 381(b), again we submit, was designed to permit a carryback to a pre-reorganization year of the transferor only when the acquiring corporation is the same taxpayer as the transferor corporation and not when the acquiring corporation is an amalgamation of separately operated and taxed enterprises.

3. An "F" reorganization involving more than a single enterprise would make Section 381(b)(1) unworkable and would run counter to the most elementary principles of taxation. Here, taxpayer, the transferor corporation, filed its pre-merger returns on a calendar year basis, while J & M, the acquiring corporation, filed its pre-merger return on a fiscal year basis. Under petitioner's theory of the "F" reorganization, taxpayer's calendar-taxable year should not have ended on the date of the merger and it should not have filed a closing return. Section 381(b) and Treasury Regulations, Section 1.381(b)-1 (a)(2). But it would have been impossible for J & M to report in the way that taxpayer did before the merger "as if there had been no reorganization" (Treasury Regulations, Section 1.381(b)-1(a)(2)) unless J & M changed its own fiscal-taxable year to a calendar year. That would have meant that in the year of the merger J & M would have reported on a basis exceeding a twelve-month period. Doubtless, to avoid that improper result, taxpayer in fact closed its taxable year on the date of the merger and J & M, the survivor, continued to report income on the same fiscal basis as before the merger. And Section 381(b)(1) plainly requires precisely that procedure. It provides a uniform rule whenever separate corporate enterprises are combined: the transferor corporation ends its taxable year on the date of the transfer and thus reports its income and expenses individually to the extent that it was separately operated for any period prior to the merger; the acquiring corporation, on the other hand, continues to file returns on the same basis as before the reorganization (except that it prospectively succeeds to the tax attributes of the transferor corporation).

Again, it can be seen that in excepting the "F" reorganization from Section 381(b)(1), Congress could only have meant the exception to apply to the reincorporation of a single corporate enterprise.

4. Section 381(a)(2) limits the carryover privilege to non-divisive "D" reorganizations (those that meet the requirements of Section 354(b)). "The section [381] does not apply * * * to divisive or other reorganizations not specified in subsection (a)." S. Rep. No. 1622, supra, p. 276 (3 U.S.C. Cong. & Adm. News (1954) 4621, 4914). The "spin-off" divisive reorganization is the exact opposite of what occurred here. In its basic form it involves a distribution of all the stock of a newly-created subsidiary corporation to the shareholders of the parent corporation. See Sections 355 and 368(a)(1)(D). In that way, business enterprises originally combined in a single corporation can be separated into two or more brother-sister corporations. Here, two brother-sister corporations were consolidated into a single entity.

Taking the expansive view of "identity" or "form" that petitioner adopts, the division of a single corporation into brother-sister corporations cannot rationally be distinguished, for purposes of applying Section 381(b), from the amalgamation of brother-sister corporations into a single corporation.

It therefore stands to reason that, if shareholder continuity were the sole and sufficient test of an "F" reorganization, as petitioner maintains, the spin-off reorganization would come under Section 381(b) through qualification as an "F" reorganization notwithstanding Congress'

intended exclusion. 14/ Neither the spin-off nor the amalgamation of brother-sister corporations is a "mere" change in the tax or business world. The separation or division of a single corporate enterprise into two brother-sister corporations further limits the liability of the common shareholders. Each corporation files its own tax return, and each obtains a surtax exemption under Section 11(d). From the opposite side of the coin, the amalgamation of two brother-sister corporations may increase efficiency or make credit more easily available because of the larger pool of assets in a single unit. And, of course, it will require the filing of one tax return and only one surtax exemption in lieu of two returns and two exemptions. If these represent "mere" changes of identify or form for purposes of the "F" provision, then every tax-free reorganization defined by Section 368(a)(1) is an "F" reorganization. 15/

A fair reading of Section 381, its legislative history, and the "F" provision itself requires the conclusion that an amalgamation of two or more separate corporate enterprises cannot be an "F" reorganization. The Fifth Circuit's alternative holding to the contrary, in

---

14/ There is also the problem that from 1934 to 1951, Congress did away with a provision that permitted the spin-off reorganization to be classed as a tax-free reorganization. Commissioner v. Baan, supra, p. 491. If the spin-off could have qualified as an "F" reorganization, Congress' purpose in repealing the provision would have been frustrated.

15/ In addition to the irreconcilable problems relating directly to Section 381 that acceptance of petitioner's theory would create, it would raise difficulties in connection with the complex Section 1244 (losses on the stock of a small business corporation). See Stauffer, supra, 48 T.C., p. 301. Section 1244(d)(2) is headed "Recapitalizations, changes in name, etc." and provides a special rule for an "F" reorganization -- obviously because it involves no more than a change in name or a reincorporation.

Davant, was in an entirely different context than this case. Section 381 was not before the Fifth Circuit and, unfortunately, the legislative evidence presented to the Tax Court and this Court was not presented to it. We consequently urge this Court not to follow the alternative ruling in Davant. For, as Judge Raum stated in Stauffer, "The Code is an extraordinarily complex and sensitive instrument, and we should be careful not to give an interpretation to one provision that would generate unintended difficulties in respect of other provisions, unless such interpretation is clearly called for by the statute itself. In the situation before us we can find no such command in the statute requiring the fusion of these three corporations to be treated as a 'mere change in identity, form, or place of organization.' To the contrary, the indications point the other way." 48 T.C., p. 302. After almost fifty years in which the "F" provision lay dormant and after Congress employed it in the 1954 Code in reliance on its highly restricted compass, it is too late in the day to enlarge it beyond its historic limits. 16/

16/ Petitioner (Br. 30-31) makes a point of language in the opinion below which seems to indicate that the merger of an operating subsidiary into an operating parent corporation might be viewed as an "F" reorganization because the parent could have filed a consolidated return although it did not do so. A reading of the entire paragraph in which the Tax Court discusses consolidated returns (I-R. 97-98) indicates that the discussion was primarily intended to distinguish Rev. Rul. 58-422, supra, which is in any event wholly consistent with the Commissioner's position (see footnote 12, supra).

D. There is no merit to petitioner's argument that the pre-merger separate existence of J & M is to be disregarded

Petitioner maintains (Br. 39-44) that taxpayer and J & M were in reality conducting the same business prior to the merger and that J & M was taxpayer's "alter ego." In other words, it is petitioner's position that its own corporate existence (when it was called J & M) was a sham and the merger with taxpayer was entirely superfluous because the two corporations were truly one from the outset. It is nevertheless questionable at best that petitioner may avoid its own existence as a jural entity or that its creator may disregard the corporate form which he freely elected. Judge Clark explained, in Commissioner v. State-Adams Corp., 283 F. 2d 395, 398-399 (C.A. 2d): "the Commissioner, to prevent unfair tax avoidance, has greater freedom and responsibility to disregard the corporate entity than a taxpayer, who normally cannot be heard to complain that a corporation which he has created, and which has served his purpose well, is a sham." Cf. Shaw Construction Co. v. Commissioner, 323 F. 2d 316, 319-320 (C.A. 9th). The Commissioner's power to treat multiple corporations as one or to otherwise pierce the corporate veil is dependent on the fact that the corporation is formed or availed of principally for tax avoidance and not for a substantial non-tax business purpose. Shaw Construction Co. v. Commissioner, supra; Aldon Homes, Inc. v. Commissioner, 33 T.C. 582. The corporate entity will be afforded recognition if it is "formed for a substantial business purpose or [it] actually * * * [engages] in substantive

business activity." 17/ Aldon Homes, Inc. v. Commissioner, supra, p. 597. See also Moline Properties v. Commissioner, 319 U.S. 436.

Under these standards, petitioner's contention must fail. J & M was admittedly "formed to operate a separate sheet metal business" (see petitiner's Br. 39), whereas taxpayer was principally in the business of fabricating metal parts. Surely, petitioner does not urge that J & M was formed and operated principally for tax avoidance. J & M -- i.e., petitioner -- was separately operated for nearly a full fiscal year prior to the merger, it filed a separate return for that period which was accepted by the Commissioner, and it was the surviving corporation on the merger. There is no authority that permits a tax litigant to disregard its own legal existence in these circumstances or under any similar facts. On the contrary, there is no basis for such a result. See Commissioner v. State-Adams Corp., supra, where claims very much like petitioner's were flatly rejected. Moreover, apart from these legal considerations, the Tax Court properly found as a fact that J & M was distinct from taxpayer. "J & M * * * was organized in December 1959 primarily to engage in a business of fabricating sheet metal products. J & M carried on a separate business, had its own customers, and negotiated its own contracts with them." (I-R. 93.) Before the merger, J & M did business in fairly large volume with eight major corporations in addition to any business it conducted with taxpayer. 18/ (I-R. 84.) The Tax Court's findings are sound.

17/ This Court, in the Shaw Construction Co. case, supra, quoted this language from Aldon Homes, Inc., with approval. 323 F. 2d, p. 320.

18/ The total volume of business with customers other than taxpayer exceeded the business conducted with taxpayer. (I-R. 84.)

CONCLUSION

For the foregoing reasons, the decision of the Tax Court should be affirmed.

Respectfully submitted,

MITCHELL ROGOVIN,
Assistant Attorney General.

LEE A. JACKSON,
HARRY BAUM,
MARTIN T. GOLDBLUM,
Attorneys,
Department of Justice,
Washington, D.C. 20530.

April, 1968.

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Dated: ________________ day of April, 1968.

____
MARTIN T. GOLDBLUM
Attorney

APPENDIX

Internal Revenue Code of 1954:

SEC. 172. NET OPERATING LOSS DEDUCTION.

(a) Deduction Allowed.--There shall be allowed as a deduction for the taxable year an amount equal to the aggregate of (1) the net operating loss carryovers to such year, plus (2) the net operating loss carrybacks to such year. For purposes of this subtitle, the term "net operating loss deduction" means the deduction allowed by this subsection.

(b) [as amended by Sec. 317(b), Trade Expansion Act of 1962, P.L. 87-794, 76 Stat. 872]. Net Operating Loss Carrybacks and Carryovers.--

(1) Years to which loss may be carried.--

(A)(i) Except as provided in clause (ii), a net operating loss for any taxable year ending after December 31, 1957, shall be a net operating loss carryback to each of the 3 taxable years preceding the taxable year of such loss.

* * * * *

(B) Except as provided in subparagraph (c), a net operating loss for any taxable year ending after December 31, 1955, shall be a net operating loss carryover to each of the 5 taxable years following the taxable year of such loss.

* * * * *

(2) Amount of carrybacks and carryovers.--Except as provided in subsections (i) and (j), the entire amount of the net operating loss for any taxable year (hereinafter in this section referred to as the 'loss year') shall be carried to the earliest of the taxable years to which (by reason of paragraph (1)) such loss may be carried. The portion of such loss which shall be carried to each of the other taxable years shall be the excess, if any, of the amount of such loss over the sum of the taxable income for each of the prior taxable years to which such loss may be carried. * * *

* * * * *

(c) Net Operating Loss Defined.--For purposes of this section, the term "net operating loss" means (for any taxable year ending after December 31, 1953) the excess of the deductions allowed by this chapter over the gross income. Such excess shall be computed with the modifications specified in subsectin (d).

* * * * *

(26 U.S.C. 1964 ed., Sec. 172.)

SEC. 368. DEFINITIONS RELATING TO CORPORATION REORGANIZATIONS.

(a) Reorganization.--

(1) In General.--For purposes of parts I and II and this part, the term "reorganization" means--

(A) a statutory merger or consolidation;

(B) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of stock of another corporation if, immediately after the acquisition, the acquiring corporation has control of such other corporation (whether or not such acquiring corporation had control immediately before the acquisition);

(C) the acquisition by one corporation, in exchange solely for all or a part of its voting stock (or in exchange solely for all or a part of the voting stock of a corporation which is in control of the acquiring corporation), of substantially all of the properties of another corporation, but in determining whether the exchange is solely for stock the assumption by the acquiring corporation of a liability of the other, or the fact that property acquired is subject to a liability, shall be disregarded;

(D) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor, or one or more of its shareholders (including persons who were shareholders immediately before the transfer), or any combination thereof, is in control of the corporation to which the assets are transferred; but only if, in pursuance of the plan, stock or securities of the corporation to which the assets are transferred are distributed in a transaction which qualifies under section 354, 355, or 356;

(E) a recapitalization; or

(F) a mere change in identity, form, or place of organization, however effected.

*   *   *   *   *

(26 U.S.C. 1964 ed., Sec. 368.)

SEC. 381. CARRYOVERS IN CERTAIN CORPORATE ACQUISITIONS.

(a) General Rule.--In the case of the acquisition of assets of a corporation by another corporation--

(1) in a distribution to such other corporation to which section 332 (relating to liquidations of subsidiaries) applies, except in a case in which the basis of the assets distributed is determined under section 334(b)(2); or

(2) in a transfer to which section 361 (relating to nonrecognition of a gain or loss to corporations) applies, but only if the transfer is in connection with a reorganization described in subparagraph (A), (C), (D) (but only if the requirements of subparagraphs (A) and (B) of section 354(b)(1) are met), or (F) of section 368(a)(1),

the acquiring corporation shall succeed to and take into account, as of the close of the day of distribution or transfer, the items described in subsection (c) of the distributor or transferor corporation, subject to the conditions and limitations specified in subsections (b) and (c).

(b) Operating Rules.--Except in the case of an acquisition in connection with a reorganization described in subparagraph (F) of section 368(a)(1)--

(1) The taxable year of the distributor or transferor corporation shall end on the date of distribution or transfer.

(2) For purposes of this section, the date of distribution or transfer shall be the day on which the distribution or transfer is completed; except that, under regulations prescribed by the Secretary or his delegate, the date when substantially all of the property has been distributed or transferred may be used if the distributor or transferor corporation ceases all operations, other than liquidating activities, after such date.

(3) The corporation acquiring property in a distribution or transfer described in subsection (a) shall not be entitled to carry back a net operating loss for a taxable year ending after the date of distribution or transfer to a taxable year of the distributor or transferor corporation.

(c) Items of the Distributor or Transferor Corporation.--The items referred to in subsection (a) are:

(1) Net operating loss carryovers.--The net operating loss carryover determined under section 172, subject to the following conditions and limitations:

(A) The taxable year of the acquiring corporation to which the net operating loss carryovers of the distributor or transferor corporation are first carried shall be the first taxable year ending after the date of distribution or transfer.

* * * * *

(3) Capital loss carryover.--The capital loss carryover determined under section 1212, subject to the following conditions and limitations;

(A) The taxable year of the acquiring corporation to which the capital loss carryover of the distributor or transferor corporation is first carried shall be the first taxable year ending after the date of distribution or transfer.

* * * * *

(26 U.S.C. 1964 ed., Sec. 381.)

SEC. 6211. DEFINITION OF A DEFICIENCY.

(a) In General.--For purposes of this title in the case of income, estate, and gift taxes, imposed by subtitles A and B, the term "deficiency" means the amount by which the tax imposed by subtitles A or B exceeds the excess of:

(1) the sum of

(A) the amount shown as the tax by the taxpayer upon his return, if a return was made by the taxpayer and an amount was shown as the tax by the taxpayer thereon, plus

(B) the amounts previously assessed (or collected without assessment) as a deficiency, over--

(2) the amount of rebates, as defined in subsection (b)(2), made.

(b) Rules for Application of Subsection (a).--For purposes of this section--

* * * * *

(2) The term "rebate" means so much of an abatement, credit, refund, or other repayment, as was made on the ground that the tax imposed by subtitles A or B was less than the excess of the amount specified in subsection (a)(1) over the rebates previously made.

* * * * *

(26 U.S.C. 1964 ed., Sec. 6211.)

Treasury Regulations on Income Tax (1954 Code):

§1.381(a)-1 General rule relating to carryovers in certain corporate acquisitions.

* * * * *

(b) Determination of transactions and items to which section 381 applies.-- * * *

* * * * *

(2) Acquiring corporation defined. (i) Only a single corporation may be an acquiring corporation for purposes of section 381 and the regulations thereunder. The corporation which acquires the assets of its subsidiary corporation in a complete liquidation to which section 381(a)(1) applies is the acquiring corporation for purposes of section 381. Generally, in a transaction to which section 381(a)(2) applies, the acquiring corporation is that corporation which, pursuant to the plan of reorganization, ultimately acquires, directly or indirectly, all of the assets transferred by the transferor corporation. If, in a transaction qualifying

under section 381(a)(2), no one corporation ultimately acquires all of the assets transferred by the transferor corporation, that corporation which directly acquires the assets so transferred shall be the acquiring corporation for purposes of section 381 and the regulations thereunder, even though such corporation ultimately retains none of the assets so transferred. Whether a corporation has acquired all of the assets transferred by the transferor corporation is a question of fact to be determined on the basis of all the facts and circumstances.

*   *   *   *   *

(3) Transactions and items not covered by section 381. (i) Section 381 does not apply to partial liquidations, divisive reorganizations, or other transactions not described in subparagraph (1) of this paragraph. Moreover, section 381 does not apply to the carryover of an item or tax attribute not specified in subsection (c) thereof. In a case where section 381 does not apply to a transaction, item, or tax attribute by reason of either of the preceding sentences, no inference is to be drawn from the provisions of section 381 as to whether any item or tax attribute shall be taken into account by the successor corporation.

*   *   *   *   *

(26 C.F.R., Sec. 1.381(a)-1.)

§1.381(b)-1 Operating rules applicable to carryovers in certain corporate acquisitions.

(a) Closing of taxable year--(1) In general. Except in the case of a reorganization qualifying under section 368(a)(1)(F), the taxable year of the distributor or transferor corporation shall end with the close of the date of distribution or transfer.

(2) Reorganizations under section 368(a)(1)(F). In the case of a reorganization qualifying under section 368(a)(1)(F) (whether or not such reorganization also qualifies under any other provision of section 368(a)(1)), the acquiring corporation shall be treated (for purposes of section 381) just as the transferor corporation would have been treated if there had been no reorganization. Thus, the taxable year of the transferor corporation shall not end on the date of transfer merely because of the transfer; a net operating loss of the acquiring corporation for any taxable year ending after the date

of transfer shall be carried back in accordance with section 172(b) in computing the taxable income of the transferor corporation for a taxable year ending before the date of transfer; and the tax attributes of the transferor corporation enumerated in section 381(c) shall be taken into account by the acquiring corporation as if there had been no reorganization.

*   *   *   *   *

(c) Return of distributor or transferor corporation. The distributor or transferor corporation shall file an income tax return for the taxable year ending with the date of distribution or transfer described in paragraph (b) of this section. If the distributor or transferor corporation remains in existence after such date of distribution or transfer, it shall file an income tax return for the taxable year beginning on the day following the date of distribution or transfer and ending with the date on which the distributor or transferor corporation's taxable year would have ended if there had been no distribution or transfer.

*   *   *   *   *

(26 C.F.R., Sec. 1.381(b)-1.)

§1.381(c)(1)-1 Net operating loss carryovers in certain corporate acquisitions.

*   *   *   *   *

(b) Carryback of net operating losses. A net operating loss of the acquiring corporation for any taxable year ending after the date of distribution or transfer shall not be carried back in computing the taxable income of a distributor or transferor corporation. However, a net operating loss of the acquiring corporation for any such taxable year shall be carried back in accordance with section 172(b) in computing the taxable income of the acquiring corporation for a taxable year ending on or before the date of distribution or transfer. If a distributor or transferor corporation remains in existence after the date of distribution or transfer, a net operating loss sustained by it for any taxable year beginning after such date shall be carried back in accordance with section 172(b) in computing the taxable income of such corporation for a taxable year ending on or before that date, but may not be carried back or over in computing the taxable income of the acquiring corporation. This paragraph may be illustrated by the following examples:

<u>Example (1)</u>. On December 31, 1954, X Corporation merged into Y Corporation in a statutory merger to which section 361 applies, and the charter of Y Corporation continued after the merger. Y Corporation sustained a net operating loss for the calendar year 1955. Y Corporation's net operating loss for 1955 may not be carried back in computing the taxable income of X Corporation but shall be carried back in computing the taxable income of Y Corporation.

<u>Example (2)</u>. On December 31, 1954, X Corporation and Y Corporation transferred all their assets to Z Corporation in a statutory consolidation to which section 361 applies. Z Corporation sustained a net operating loss for the calendar year 1955. Z Corporation's net operating loss for 1955 may not be carried back in computing the taxable income of X Corporation or Y Corporation.

<u>Example (3)</u>. On December 31, 1954, X Corporation ceased all operations (other than liquidating activities) and transferred substantially all its properties to Y Corporation in a reorganization qualifying under section 368(a)(1)(C). Such properties comprised all of X Corporation's properties which were to be transferred pursuant to the reorganization. In the process of liquidating its assets and winding up its affairs, X Corporation sustained a net operating loss for its taxable year beginning on January 1, 1955. This net operating loss of X Corporation shall be carried back in computing the taxable income of that corporation but may not be carried back or over in computing the taxable income of Y Corporation.

* * * * *

(26 C.F.R., Sec. 1.381(c)(1)-1.)